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# In the Supreme Court of the United States

OCTOBER TERM, 1983

WINTHROP P. ROCKEFELLER, PETITIONER

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT*

**MEMORANDUM FOR THE UNITED STATES IN OPPOSITION**

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Section 4941 of the Internal Revenue Code imposes an excise tax on acts of self-dealing between private foundations and certain related persons. Petitioner contends that Section 4941 and its interpretive Regulations are unconstitutional under the Tenth Amendment.

1. Petitioner's father died on February 22, 1973, leaving the residue of his estate to a charitable trust created under his will. He bequeathed to the charitable trust property known as Winrock Farms, property that his will contemplated would constitute a substantial part of the trust's assets (Pet. App. 3a). His will also provided that any property held by his estate could be sold to a member of his family, including petitioner, provided that the sale was for fair market value (C.R. 108).[1]

[1] "C.R." refers to the original record on appeal as repaginated by the clerk of the district court and transmitted to the court of appeals.

On September 30, 1975, petitioner reached an agreement with the executors to purchase Winrock Farms from the estate (Pet. App. 4a). The parties secured an appraisal of the property and requested approval of the sale from the probate court. The probate court entered an order approving the sale at the appraised figure, and the purchase was consummated on December 19, 1975 (*ibid.*).

On audit, the Commissioner determined that petitioner had purchased Winrock Farms from the estate for considerably less than its fair market value, and accordingly proposed deficiencies against petitioner under Section 4941(a)(1) of the Code.[2] That Section imposes an excise tax "on each act of self-dealing between a disqualified person and a private foundation." It defines "self-dealing" to include "any direct or indirect * * * sale or exchange * * * of property between a private foundation and a disqualified person" (I.R.C. § 4941(d)(1)(A)), and provides that the tax "shall be paid by any disqualified person * * * who participates in the act of self-dealing" (I.R.C. § 4941(a)(1)). The Commissioner determined that the charitable trust created by the decedent's will was a "private foundation" (see I.R.C. § 4947(a)(1)); that petitioner, as a member of the decedent's family, was a "disqualified person" with respect to the charitable trust (see I.R.C. § 4946(a)(1)); and that, since Winrock Farms was destined to become the principal asset of the charitable trust, petitioner's purchase of that property from the estate for less than its fair market value was an "indirect act of self-dealing" between petitioner and the trust (Pet. App. 4a-5a). The Commissioner based his determination in part on Section 53.4941(d)-1(b)(3) of the Treasury Regulations, which defines "indirect self-dealing" to include "a transaction with respect to a private

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[2]Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

foundation's interest or expectancy in property * * * held by an estate," unless the estate in the transaction "receives an amount which equals or exceeds the fair market value of the foundation's interest or expectancy in such property."

Petitioner appealed the proposed deficiencies administratively, eventually reaching a closing agreement with the IRS (Pet. App. 5a). Under that agreement, petitioner stipulated that the fair market value of Winrock Farms was $6.8 million higher than the price he had paid the estate (C.R. 91-93). He consented to the assessment of $2.1 million in excise tax for 1975-1980, reserving the right to recover that sum in a refund suit (Pet. App. 5a-6a). He agreed that the only questions presented in such a refund suit would be the validity and applicability of Section 4941 and its implementing regulations (*id.* at 6a). Petitioner in due course filed suit in the United States District Court for the Eastern District of Arkansas, challenging the constitutionality of Section 4941 and of Treas. Reg. § 53.4941(d)-1(b)(3) (Pet. App. 2a, 3a). The district court rejected his constitutional arguments (*id.* at 6a-8a) and upheld the validity of the challenged Regulation (*id.* at 8a-12a). The court of appeals affirmed in a per curiam decision (*id.* at 1a-2a).

2. Petitioner reiterates his arguments against the constitutionality of Section 4941, contending (Pet. [illegible]pp. 5-8) that the statute, while in form imposing an excise tax, is in substance a penalty designed to regulate the activities of charitable trusts, a matter that in petitioner's view has been reserved to the states by the Tenth Amendment. Petitioner bases his argument on *Bailey* v. *Drexel Furniture Co.*, 259 U.S. 20 (1922), the "Child Labor Tax Case." This Court there invalidated the federal Child Labor Tax Law, reasoning that the tax was in substance "a regulation of the employment of child labor in the States," a function that the Court regarded as "an exclusively state function" under the Tenth Amendment. 259 U.S. at 36.

Petitioner's contention is meritless. While "[i]t is true that the Court in [certain early] cases drew what it saw at the time as distinctions between regulatory and revenue-raising taxes," the Court "has subsequently abandoned such distinctions." *Bob Jones University* v. *Simon*, 416 U.S. 725, 741 n.12 (1974). It is now well established that "a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the activities taxed." *United States* v. *Sanchez*, 340 U.S. 42, 44-45 (1950). A tax statute must be upheld as a valid exercise of Congress's taxing power even though revenue-raising is a secondary purpose, and even though the revenue raised is negligible, unless the statute contains "provisions extraneous to any tax need." *United States* v. *Kahriger*, 345 U.S. 22, 31 (1953), overruled on other grounds, *Marchetti* v. *United States*, 390 U.S. 39 (1968). Accord, *Pittsburgh* v. *Alco Parking Corp.*, 417 U.S. 369, 373-379 (1974); *Sonzinsky* v. *United States*, 300 U.S. 506, 512-514 (1937).

Section 4941 is plainly constitutional under these standards. That statute, as the courts below noted, was enacted "to prevent various abuses surrounding tax-exempt organizations" (Pet. App. 2a, 7a). Contrary to petitioner's contention (Pet. 8), the statute was designed to raise, and does in fact raise, revenue; indeed, the fact that $2.1 million in excise tax deficiencies were assessed against petitioner belies his view. Besides raising revenue directly, Section 4941 enhances the fisc indirectly by preventing abuse of the Code's provisions respecting charitable organizations. The statute discourages taxpayers from using private foundations to gain unwarranted tax advantages, in the form of charitable tax deductions or charitable tax exemptions, where amounts have been diverted from the charity by self-dealing and have thus inured to the benefit of private individuals. See S. Rep. 91-552, 91st Cong., 1st Sess. 28-29 (1969); H.R. Rep. 91-413 (Pt. 1), 91st Cong., 1st Sess. 20-21

(1969). In short, as the district court properly concluded (Pet. App. 8a), Section 4941 ensures "that revenue will be collected under income, estate, and gift tax laws which otherwise might have gone uncollected."[3]

3. Petitioner's challenge to the constitutionality of Section 53.4941(d)-1(b)(3) of the Regulations, on the theory that it "expands [Section] 4941 into an area outside of congressional intent" (Pet. i), is equally without merit. As noted above (see pages 2-3, *supra*), that Section defines "indirect self-dealing" between a private foundation and a disqualified person to include certain transactions "with respect to [the] foundation's interest or expectancy in property * * * held by an estate." Petitioner emphasizes that he bought Winrock Farms from the executors of the estate, not from the charitable trust, and asserts that there is "no evidence in the legislative history of [Section] 4941 that Congress was concerned about transactions with estates" (Pet. 10).

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[3]There is no merit to petitioner's contention (Pet. 7) that Section 4941 interferes with state laws governing estates and charitable trusts, or, indeed, that regulation of such matters is reserved exclusively to the states by the Tenth Amendment. Cf. *Knowlton* v. *Moore*, 178 U.S. 41 (1900). The Internal Revenue Code, with its elaborate provisions governing charitable tax deductions and exemptions, necessarily "regulates" these areas. In enacting Section 4941, moreover, Congress intended, not to obstruct local law, but to "facilitate effective State enforcement of State common law and statutory regulation of funds dedicated to charitable purposes." Staffs of Joint Comm. on Internal Revenue Taxation, 91st Cong., 1st Sess. 13, *Summary of H.R. 13270, Tax Reform Act of 1969* (Comm. Print 1969) (As Passed By The House of Representatives); S. Rep. 91-552, 91st Cong., 1st Sess. (1969). In any event, petitioner can scarcely complain that Section 4941 has interfered with state laws governing charitable trusts here, since he concededly purchased property bequeathed to a charitable trust for $6.8 million less than its fair market value.

The courts below properly rejected this argument (Pet. App. 2a, 9a-10a). Section 4941(d)(1)(A) by its terms covers "any direct or indirect" sale or exchange between a disqualified person and a private foundation. The challenged Regulation, in interpreting this phrase to cover an anticipatory sale by an estate to a disqualified person of property destined to fund a private foundation, is neither unreasonable nor plainly inconsistent with the statute. *Commissioner* v. *Portland Cement Co.*, 450 U.S. 156, 159 (1981). Congress aimed to prevent sophisticated, as well as blatant, abuses in the private foundation area, and "[i]t logically follows that Congress would be concerned about the circumvention of an estate's assets which are earmarked for a private foundation, especially in a case such as this, where the bulk of the estate is bequeathed to a charitable trust" (Pet. App. 10a). Any other result would permit evasion of the self-dealing rules simply by having the disqualified person purchase the property before, rather than after, the charitable trust is funded. The challenged Regulation embodies the reasonable conclusion that Congress intended to reach just such attempts at evasion by imposing a tax on acts of self-dealing effectuated by "any direct or indirect" means. And even if the validity of the Regulation were seriously open to question, petitioner concedes (Pet. 9) that there is no conflict among the circuits on the issue.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
*Solicitor General*

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